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SUBJECT: SOUTH KOREA ECONOMIC BRIEFING - SEPTEMBER 2009

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Domestic Economy  
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12. (SBU) National Income Resurges in the Second Quarter: The Bank of Korea (BOK) announced that real gross national income (GNI) totaled 240.8 trillion won (USD 199 billion) in the second quarter, up 0.5 percent from a year earlier while real gross domestic product (GDP) declined 2.2 percent to 244.5 trillion won (USD 202 billion). On a quarter-on-quarter basis, however, real GNI rose 5.6 percent, the largest gain in 21 years, while real GDP rose 2.6 percent, the largest climb in over five years.

13. (SBU) ROKG Set 2010 Budget at 291.8 Trillion Won: The Korean government's 2010 budget proposal, unveiled on September 28, contains a good deal of fiscal tightening. According to the proposal, fiscal revenue will increase by 2.9 percent and fiscal spending will decline by 3.3 percent compared with the 2009 budget. The government also expects the consolidated fiscal deficit to narrow significantly to 4 trillion won (USD 3.3 billion) in 2010 from 22 trillion won (USD 18.2 billion) this year, implying a decline to 0.4 percent from 2.1 percent. The budget proposal

assumes that government debt will rise to 407.1 trillion won (USD 336.4 billion), or around 37 percent of GDP, in 2010 from 366 trillion won (USD 302.5 billion) in 2009. The reduction in fiscal spending will be most pronounced in the areas of industry and SME support. The proposed decline in infrastructure spending will be offset by increased spending by state-owned companies. For example, the Korea Water Resources Corporation will spend 3.2 trillion won (USD 2.6 billion) in 2010 on the Four Rivers Restoration Project, which will complement government spending of 3.5 trillion won (USD 2.9 billion) on the same project. The government emphasizes that welfare spending as a share of total fiscal spending is at a historical high of 27.8 percent, though the budget for public-sector job creation will be reduced by 1.2 trillion won (USD 1 billion). A rather significant cut in public administration spending is partially explained by the freezing of public employees' wages for two years. The budget bill will be submitted to the National Assembly by October 2.

Unit: trillion won	2009 budget*	Proposed 2010 Budget	Percent Change
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Total fiscal revenue	279.8	287.8	2.9
Total fiscal spending	301.8	291.8	-3.3
Consolidated	-22.0	-4.0	N/A
Fiscal Balance			
Percent of GDP	-2.1	-0.4	N/A
Government Debt	366.0	407.1	N/A
Percent of GDP	35.6	36.9	N/A
Research & development	12.7	13.6	7.1

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Industry, SME, Energy	20.8	14.4	-30.8
Infrastructure	25.5	24.8	-2.7
Agriculture and Food	17.4	17.2	-1.1
Health, welfare, and Labor	80.4	81.0	0.7
Education	39.2	37.8	-3.6
Defense	29.0	29.6	2.1
Public Order, Safety	12.4	12.9	4.0
Public Administration	51.6	49.5	-4.1

\*Including the supplementary budget passed by the National Assembly in April 2009

14. (SBU) KDI Raises 2009 Growth Forecast: The Korea Development Institute (KDI), a state-run research institute, raised its 2009 GDP growth forecast to -0.7 percent from -2.3 percent and its 2010 forecast to 4.2 percent from 3.7 percent. The Institute's 2009 projection is the highest among major domestic research institutes, and much higher than figures presented by the government (-1.5 percent) and the Bank of Korea (-1.6 percent). KDI said because exports and consumption are improving much faster than expected, the government should put the highest priority on ensuring a stable transition from crisis to recovery when deciding future macroeconomic policy. Meanwhile, the Finance Minister continued to affirm plans for an expansionary economic policy.

15. (SBU) South Korea Ranks Nineteenth in Global Competitiveness: According to the World Economic Forum's survey of international competitiveness, South Korea ranked nineteenth in 2009, down a disappointing six places from 2008. The score was dragged down in large part by the labor market efficiency indicator, which plummeted to eighty-fourth from forty-first last year.

16. (SBU) ROKG Records Huge Deficit in the First Half: The Ministry of Strategy and Finance (MOSF) revealed a budget deficit of 28 trillion won (USD 23.1 billion) as of the end of June, with 133 trillion won (USD 110 billion) in revenues and 161 trillion won (USD 133.2 billion) in expenditures and net lending. Though the deficit was 6 trillion won (USD 5 billion) more than expected, the government anticipates that the deficit will shrink in the second half of the year.

17. (SBU) Korea's Trade Surplus Dips to USD 1.6 Billion in August: South Korea recorded a trade surplus of USD 1.67 billion in August,

but the figure represented a sharp decline from the previous several months - USD 7.27 billion in June and USD 4.41 billion in July. According to the Ministry of Knowledge Economy, exports fell 20.6 percent year-on-year to USD 29.08 billion in August while imports shrank 32.2 percent to USD 27.41 billion. Ministry officials said both exports and imports will increase from September, noting that the fourth largest economy in Asia will continue to post monthly trade surpluses of more than USD 1 billion until the end of this year.

18. (SBU) Employment Grows Modestly in August: According to the National Statistical Office (NSO), 23.62 million people were employed in August, up 3,000 from a year earlier, reversing the trend from a 76,000 job loss in July. The nation saw the first job increase of 4,000 in June when companies added 78,000 new workers to their payrolls. In May, 219,000 jobs disappeared from the previous year, marking the highest year-on-year job losses since March 1999 when the country lost 390,000 positions from a year before as a result of massive corporate layoffs following the 1997-98 Asian financial crisis. The number of unemployed came to 905,000 in August, up 141,000 from the previous year, with the jobless rate rising to 3.7 percent from 3.1 percent. The jobless rate among young people aged 15 to 29 surged to 8.2 percent from 7.1 percent a year ago.

19. (SBU) USD 100 Billion Designated for Regional Development: The government will spend a total of 126 trillion won (USD 104 billion) over the coming five years on the country's regional development. All Korean provinces will be regrouped into seven regions with differentiated outlines to develop business and secure global competitiveness, as well as build up the quality of life for residents. The blueprint will be put into effect next month, following approval from the Cabinet and the President. Of the earmarked budget, 71.2 trillion won (USD 58.8 billion) will come

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from the central government, with 24.3 trillion won (USD 20 billion) and 30.9 trillion won (USD 25.5 billion) to be created by regional administrations and private investments, respectively.

#### Finance and Structural Policies

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10. (SBU) KOSPI, Won Value Move Higher: The benchmark KOSPI stock index soared in September, touching the 1,700 mark for the first time in 15 months, and the value of won strengthened, testing its highest level in a year. The main KOSPI gained 610.1 points or 57.4 percent from the end of February this year, to end at 1,673.14 on September 30, while the Korean won continued to rally against the U.S. dollar, closing at 1,178.1 won, appreciated 355.9 won or 23.2 percent. Surging foreign portfolio investment was in part spurred by the Financial Times Stock Exchange's (FTSE) upgrading of Korean shares from the emerging markets group to the top-tier developed markets.

11. (SBU) USD 1.7 Billion in Microcredit Planned for the Poor: Starting in December, people with low credit ratings will be able to borrow money from microcredit banks, which will lend funds contributed by conglomerates and financial firms. President Lee Myung-bak chaired a cabinet meeting on September 17 at which the ROKG decided to lend 2 trillion won (USD 1.7 billion) during the next 10 years to those who cannot borrow money from banks due to their low ratings. The maximum amount extended to individuals is expected to reach thousands of dollars and repayment would be made over four years with a one-year grace period. Out of the 2 trillion won of microcredit funds, local conglomerates will donate 1 trillion won (USD 826 million) as promised by the Federation of Korean Industries, which represents large corporations. Around 700 billion won (USD 579 million) would come from inactive bank accounts in which there have not been any transactions or inquiries for longer than five years. The remaining 300 billion won (USD 248 million) will be donated by banks or securities institutions.

12. (SBU) Fitch Upgrades Korea's Credit Rate Outlook to Stable: Fitch Ratings upgraded its credit prospects on Korea to 'stable'

from 'negative,' with Korea's sovereign credit rating unchanged at A+. The change reflected Korea's economic recovery. The forecast returned to 'stable' after being lowered to 'negative' in November 2008. Meanwhile, Standard and Poor's has maintained Korea's A rating with a stable outlook since 2005, while Moody's has kept its A2 rating with a stable outlook.

13. (SBU) Korea's FDI Ranking Jumps to Forty-fourth: Foreign direct investment (FDI) in South Korea nearly tripled in 2008 due to aggressive economic stimulus programs and favorable exchange rates, the U.N. Conference on Trade and Development (UNCTAD) said in a report on September 18. The country posted a total of USD 7.6 billion in FDI inflow, up 22 notches to the forty-fourth largest amount in the world, jumping from USD 2.6 billion in 2007. Before 2008, Korea's FDI inflow had been falling consistently after hitting USD 9 billion in 2004. Korea's aggregate amount of the FDI stood at nearly USD 90.7 billion as of end-2008, accounting for 9.8 percent of its gross domestic product. The report praised Korea's overall performance amid the financial crisis and forecast a large stimulus plan by the government and a weakening won may help the economy maintain positive growth and the recovery in FDI in the coming years.

14. (SBU) Doosan to Purchase Czech Turbine Maker for USD 655 Million: Doosan Heavy Industries & Construction has agreed with Skoda Power to buy all shares in the Czech turbine maker. The USD 655-million deal is the latest in a series of takeovers by the group, which purchased Bobcat of the United States in 2007. Doosan's purchase of the 150-year-old turbine maker, which sells products in over 60 countries, would also help the company's power generation and engineering business, securing turbine technologies, the company said. Doosan Heavy, led by CEO Park Gee-won, is South Korea's biggest power equipment maker and also produces industrial facilities, machine tools and construction equipment.

15. (SBU) Koreans' Overseas Credit Card Spending Rises Sharply: The BOK revealed that Koreans spent USD 1.28 billion overseas with their credit cards during the second quarter, up 16.6 percent from USD 1.1

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billion in the previous quarter. The quarter-on-quarter growth was the highest since hitting 27.4 percent in the third quarter of 2003. Also, as of the end of June, total credit cards issued reached 100.27 million, up 7.3 percent from a year earlier.

16. (SBU) BOK Keeps Interest Rate at Two Percent: The BOK's Monetary Policy Committee decided to maintain the current annual benchmark interest rate of 2.00 percent until October 9. The BOK cut the rate from 5.25 percent in October 2008, all the way down to 2.00 percent in February 2009. BOK Governor Lee Seong-tae said the timing of a shift in monetary policy will depend on how the local housing market unfolds. His remarks were viewed by analysts as stating the BOK has turned more hawkish as there are growing concerns over a possible property bubble triggered by a surge in household loans.

17. (SBU) Korea's Business Environment Ranks Nineteenth: The World Bank's "Doing Business 2010" report placed Korea at 19 among 183 countries, up four places from 2009. The Finance Ministry credited the upgrade to improvements on start-up procedures (up from 126 to 53) and international trade (up from 12 to 8).

18. (SBU) KB Financial Chairman Hwang Resigns: KB Financial Group Chairman Hwang Young-key resigned on September 23 after he received a "suspension of duty" penalty from the financial regulator. In a statement on September 14, the Kookmin Bank union, the flagship of KB Financial Group, strongly urged Hwang to step down, citing the Financial Supervisory Service decision to suspend Hwang from duty for incurring USD 1.6 billion losses while at the helm of Woori Bank.

TOKOLA